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Impact investing for diversification

By

Investments for economic diversification: Environmental, social and governance-related transparent reporting

The views expressed are those of the author and do not necessarily reflect the views of UNCTAD.
SMEs: IMPACT AT GRASSROOTS

- SMEs create more jobs per unit of capital
- SMEs provide food security
- SMEs provide incomes
- Touch the lives of 2.5bn people

Source: FAO
FOUR REASONS SMEs LACK CAPITAL

• Commodity SMEs vulnerable: reliance on commodities carries huge costs
• Commodity dependence – persistent outcome of commodity related vulnerability
• Diversification requires investment, but...
• ... SMEs are costly to invest: small tickets, high risks

Diversification for CDDCs requires financing, to change the outcome, change the rules
Impact investors offer new hope
THE LANDSCAPE OF IMPACT PRACTICE

Triple Bottom Line Investing
Impact Investing
PRI
ESG
SRI
ESG: EXAMPLES

There is no one exhaustive list of ESG issues. ESG issues are often interlinked, and it can be challenging to classify an ESG issue as only an environmental, social, or governance issue.

ESG issues can often be measured (e.g., what is the employee turnover for a company?), but it can be difficult to assign them a monetary value (e.g., what is the cost of employee turnover for a company?).

<table>
<thead>
<tr>
<th>Environmental</th>
<th>Social</th>
<th>Governance</th>
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</thead>
<tbody>
<tr>
<td>Climate change</td>
<td>Customer satisfaction</td>
<td>Board composition</td>
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<td>and carbon emissions</td>
<td>Data protection and privacy</td>
<td>Audit committee structure</td>
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<td>Air and water</td>
<td>Gender and diversity</td>
<td>Bribery and corruption</td>
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<td>pollution</td>
<td>Employee engagement</td>
<td>Executive compensation</td>
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<td>Biodiversity</td>
<td>Community relations</td>
<td>Lobbying</td>
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<td>Deforestation</td>
<td>Human rights</td>
<td>Political contributions</td>
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<td>Energy efficiency</td>
<td>Labor standards</td>
<td>Whistleblower schemes</td>
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<tr>
<td>Waste management</td>
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<td>Water scarcity</td>
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RESPONSIBLE INVESTING

PRI’s MISSION:
“We believe that an economically efficient, sustainable global financial system is a necessity for long-term value creation. Such a system will reward long-term, responsible investment and benefit the environment and society as a whole.”

What? – global financial system:
• Economically efficient
• Sustainable

How? – reward investment which is
• Long term
• Responsible
  • Benefit environment
  • Benefit society as a whole
## Financing Full Range of Options

<table>
<thead>
<tr>
<th>Traditional</th>
<th>Responsible</th>
<th>Sustainable</th>
<th>Impact Investment</th>
<th>Philanthropy</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Competitive returns</strong></td>
<td><strong>ESG risk management</strong></td>
<td><strong>ESG opportunities</strong></td>
<td><strong>High-impact solutions</strong></td>
<td></td>
</tr>
<tr>
<td>Finance Only</td>
<td>Focus on ESG risks ranging from a wide consideration of ESG factors to negative screening of harmful products</td>
<td>Focus on ESG opportunities, through investment selection, portfolio management and shareholder</td>
<td>Focus on one or a cluster of issue areas where social or environmental need creates a commercial growth opportunity for market-rate or market-beating returns</td>
<td>Focus on one or a cluster of issue areas where social or environmental need requires some financial trade-off</td>
</tr>
</tbody>
</table>
| Examples | • PE firm integrating ESG risks into investment analysis  
• Ethically screened investment fund | • “Best-in-class” SRI fund  
• Long-only public equity fund using deep integration of ESG to create additional value | • Clean energy mutual fund  
• Emerging markets healthcare fund  
• Microfinance structured debt fund | • Fund providing debt or equity to social enterprises and/or trading charities |

Source: European SRI Study
IMPACT INVESTING: THE DIFFERENCE

ESG Investment/PRI based strategy

• Can be pursued for financial profit only
• ESG awareness as long term risk mitigation strategy
• Primarily about bringing additional data and analysis into existing approaches

Impact/Ethical/Green Investment

• Financial and non-financial returns explicitly targeted
• Non-financial returns not monetized but reported to conscious investors
INVESTING IN DEVELOPMENT IMPACT

- Development impact funds – from 100% social impact targets towards Triple Bottom Line (TBLI)
- Ambition – to create investable instruments from non-profit activities for private impact investors
- Sustainable Development Goals – common language for coherent collaboration on ESG

**Responsible**
- Market rates of return
- ESG indicators enhance the risk profile

**Impact**
- Concessional rates, cover losses
- ESG impact indicators supplement financial return

**Non-profit**
- Below par rates of return, subsidized
- ESG impact the main indicator
IMPACT INVESTING GROWTH

• ESG considerations are not new, increasingly recognized to be a positive factor in asset valuations
• UN’s PRI and SDG create publicity and demand for Impact Investments – most major financial players have impact funds
• AUM estimated $715 billion (GIIN) to $2.1 trillion (IFC), growth around 20%pa
• “The industry is constrained by lack of instruments” (the Economist, 5 Jan 2017)

CHALLENGE: connect impact investors to diversification of SMEs in CDDCs
PRACTICING SUSTAINABLE DEVELOPMENT GOALS

The SDGs provide a common framework regarding impact:

• Mapping impact metrics to the SDGs and underlying targets

• Market impact to investors, clear impact expectations for investee companies, contribute to global image of a stronger impact investing industry

Communication about ESG impact of financial investments brings more capital into impact investing
MEASURING ESG/SDG

- IRIS+ metrics by GIIN
- Global Reporting Initiative/SDG Compass
- Impact Management Project
- GIIRS
- SFDR
INSTRUMENTS: FUNDS, GREEN BONDS, IBs

Tailored products whose remit overlaps with areas responsible investment
Part of a responsible investment strategy.

<table>
<thead>
<tr>
<th>Environmentally- or socially-themed funds</th>
<th>Green bonds</th>
<th>Impact bonds</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Standard management compensation ~ 2%</td>
<td>• Finance for projects consistent with Green Bond Principles</td>
<td>• Transfers the risk of subsidized projects to investors</td>
</tr>
<tr>
<td>• Lower hurdle rate of less than 10%</td>
<td>• Top credit quality eg. by WB and IFC</td>
<td>• Makes social results directly tradeable</td>
</tr>
<tr>
<td>• Obligation to report on impact indicators</td>
<td>• Fixed income returns</td>
<td>• Returns unconnected with financial markets</td>
</tr>
<tr>
<td>• Frequently, specific theme for investment, e.g. African Agriculture, SMEs, EcoEnterprises, Agroforestry</td>
<td>• Commitment to transparency and reporting in the use of proceeds</td>
<td>• Costly verification – directly material</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• COMPLEX MULTI-PARTY LEGAL STRUCTURE</td>
</tr>
</tbody>
</table>
IMPACT BOND

For details see doi: 10.3362/1755-1986.16-00029
CFC INNOVATION: The Commodity Impact Investment Facility (CIIF)

A new Fund operated by CFC - open to private and public impact investors interested to finance the transition to a sustainable agricultural system. Investing in farm-to-fork strategies for climate resilience, innovations, and sustainable trade with high impact on livelihoods.

**KEY HIGHLIGHTS**

- **USD 20 million** anchor investment approved by CFC member countries in December 2021. Includes commitment for first-loss tranche.
- **Wide geographic coverage** in agri/commodity value chains in Africa, Asia and Latin America.
- Commitment to transfer 4 - 8 existing, high-performing CFC investments to the CIIF.
- **Financing instruments tailored to the needs of** agri/commodity businesses in developing countries, including long term loans, trade/working capital facilities, and development impact bonds.
- **Technical assistance facility managed** by CFC’s expert team to maximize the impact and viability of the investments.
THREE STEPS TO SECURE TRUST WHEN INVESTING IN SMEs

Jobs and income security

1. Working capital

2. Trade finance

3. CAPEX for sustainable future

Investment and growth

Sustainable future for planet and society

SME

Grassroot SMEs

Commodities

Information

Market info

Products

Investment in and growth

CIIF Management Team

1+2+3 = capital preservation + income

CFC common fund for commodities
THANK YOU! FOR MORE INFORMATION

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